

China
ADD (no change)

Consensus ratings*: Buy 34 Hold 4 Sell 1

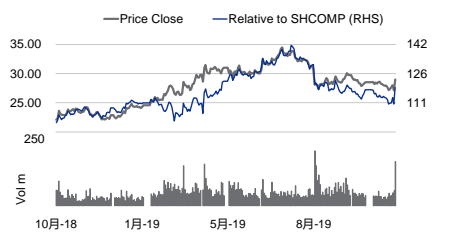
Current price:	Rmb29.00
Target price:	Rmb34.50 ▲
Previous target:	Rmb34.00
Up/downside:	19.0%
CGI / Consensus:	5.3%

Reuters:	600887.SS
Bloomberg:	600887 CH
Market cap:	US\$25,055m
	Rmb176,817m
Average daily turnover:	US\$204.4m
	Rmb1,497m
Current shares o/s:	6,078m
Free float:	62.3%

*Source: Bloomberg

Key changes in this note

- FY19F EPS increased by 1.5%.
- FY20F EPS increased by 0.9%.
- FY21F EPS decreased by 2.7%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	1.7	-7.1	31.3
Relative (%)	.9	-7	18.8

Major shareholders

	% held
Hong Kong Securities Clearing Co L	14.9
Huhe Haote Investment Co Ltd	8.9
Pan Gang	3.9

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Inner Mongolia Yili Indus-A

Better margin expansion in 3Q19

- Yili reported net profit growth of 15.5% in 3Q19 and 11.6% yoy in 9M19, slightly better than we expected, mainly because of stronger margin expansion.
- We expect Yili to continue to upgrade its product mix to drive up its margins in 4Q19F and FY20F.
- Management expects the raw milk price to increase 5–6% yoy in FY20F, which should lead to a reduction in promotion levels.
- Maintain Add with new DCF-based TP of Rmb34.5.

Stronger-than-expected 3Q19 results

Yili's revenue grew 10.8% and 12.6% yoy in 3Q19 and 9M19. We estimate that sales volume grew 6–7% yoy in 9M19, and a mix upgrade drove up the ASP by 4%. Yili also reduced its pricing promotion in 9M19, which led to ASP improvement of c.2%. Its gross margin expanded 0.3ppt yoy to 35.5% in 3Q19, since the mix upgrade and promotion reduction fully offset the raw milk price increase. Yili said the raw milk price was up 8.5% yoy in 3Q19 and 7% yoy in 9M19, due to strong downstream dairy demand. Yili continued to gain market share in 9M19, gaining a 2ppt yoy market share for liquid milk to 38.8% by end-3Q19. According to ACNielsen data, the industry volume growth of liquid milk was 2% in 9M19, with normal temperature milk up 3% and low temperature products down 2.5%. We now expect Yili's revenue to grow 12.8%/11.4% yoy in FY19F/FY20F.

Mix upgrade to continue

Yili continued product premiumization in 3Q19, and sales of high-end products continued to grow faster. Sales of its high-end UHT milk, Santine, and room temperature yoghurt, Ambrosial, grew 17% and 17.8% yoy in 9M19 (3Q19: high-teens and 15% yoy growth). Sales of high-end infant milk powder increased 28.6% yoy in 8M19. Yili launched dream cover organic Santine milk with protein content of 3.8g in Sep, and will launch fat free dream cover soon. It will also launch new low-temperature products in 4Q19F. We expect low temperature sales growth to return to positive yoy in FY20F, from -1% yoy in 9M19, and Yili to continue to upgrade its product mix to drive up margins in 4Q19F and FY20F.

Exploring new business opportunities

Yili set up healthy drinks and cheese business units in 2H18, and launched a soy milk drink last year. Management expects soy milk sales to grow in the mid-teens yoy in FY19F to Rmb500m–600m. Children's cheese launched early this year received positive market feedback. This month, Yili launched mineral water products and will expand its water capacity in FY20–21F. Currently, Yili has c.2,000 distributors for its healthy drinks, half of them existing dairy distributors and the remaining half new.

Promotion levels to fall gradually

Because of a reduction in promotion and good operating leverage, its distribution expenses ratio was down by 2.4%pts yoy in 3Q19, which completely offset the increase in the G&A expenses ratio of 1.3%pts, leading to OPM improvement of 0.8%ppt yoy to 9.6% in 3Q19. Management expects the raw milk price to increase 5–6% yoy in FY20F, which should lead to a reduction in promotion levels. We expect Yili to maintain stable OPM yoy in FY20F.

Maintain Add with new DCF-based TP of Rmb34.5

We fine tuned our FY19–21F earnings forecasts by 1.5%/0.9%/-2.7% to reflect better margin assumptions and expenses related to Yili's restricted share plan. We maintain our Add rating, since we like Yili's product premiumization and lower promotion level. A positive catalyst is stronger margin expansion owing to better control of expenses. And the main risk is higher-than-expected raw milk prices.

Financial Summary

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue (Rmbm)	67,547	78,976	89,125	99,250	109,914
Operating EBITDA (Rmbm)	8,705	9,303	10,151	11,354	12,851
Net Profit (Rmbm)	6,001	6,440	7,102	7,859	8,873
Core EPS (Rmb)	1.00	1.07	1.18	1.31	1.47
Core EPS Growth	6.3%	7.4%	10.3%	10.5%	12.7%
FD Core P/E (x)	29.08	26.99	24.50	22.17	19.66
DPS (Rmb)	0.70	0.70	0.77	0.85	0.96
Dividend Yield	2.42%	2.41%	2.66%	2.95%	3.33%
EV/EBITDA (x)	18.40	17.73	16.31	14.59	12.85
P/FCFE (x)	15.19	NA	43.35	34.09	27.64
Net Gearing	(55.3%)	(34.0%)	(29.2%)	(26.8%)	(26.0%)
P/BV (x)	7.00	6.31	5.81	5.34	4.90
ROE	25.1%	24.6%	24.7%	25.1%	26.0%
% Change In Core EPS Estimates			1.03	1.02	1.02
CGI/consensus EPS (x)					

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Better margin expansion in 3Q19

Figure 1: Yili's quarterly financial performance review

(Rmb m)	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	yoy	FY18	FY19F	yoy	9M18	9M19	yoy
Operating Revenue	19,576	20,013	21,258	18,130	23,077	21,888	23,552	11%	78,976	89,125	13%	60,846	68,517	13%
YoY (%)	25%	14%	13%	18%	18%	9%	11%		17%	13%		17%	13%	
Gross Profit	7,451	7,565	7,473	6,850	9,051	7,964	8,359	12%	29,339	33,103	13%	22,489	25,374	13%
Other operating income	360	454	372	360	214	444	251	-33%	1,546	1,138	-26%	1,186	909	-23%
Sale and distribution expense	-4,497	-5,673	-5,164	-4,439	-5,566	-5,536	-5,149	0%	-19,773	-21,618	9%	-15,334	-16,251	6%
General Administrative expense	-752	-646	-801	-1,208	-1,036	-1,082	-1,192	49%	-3,407	-4,156	22%	-2,199	-3,309	51%
Operating profit	2,562	1,700	1,881	1,564	2,663	1,791	2,269	21%	7,706	8,466	10%	6,143	6,723	9%
Net Profit	2,100	1,346	1,602	1,392	2,276	1,505	1,850	15%	6,440	7,102	10%	5,048	5,631	12%
YoY (%)	21%	-17%	2%	31%	8%	12%	15%		7%	10%		2%	12%	
Margins								ppt chg			ppt chg			ppt chg
GPM incl: sales tax	38.1%	37.8%	35.2%	37.8%	39.2%	36.4%	35.5%	0.3%	37.1%	37.1%	0.0%	37.0%	37.0%	0.1%
Sales tax	0.7%	0.7%	0.6%	0.6%	0.7%	0.7%	0.5%	-0.1%	0.7%	0.7%	0.0%	0.7%	0.7%	-0.1%
S&D expense ratio	23.0%	28.3%	24.3%	24.5%	24.1%	25.3%	21.9%	-2.4%	25.0%	24.3%	-0.8%	25.2%	23.7%	-1.5%
G&A expense ratio	3.8%	3.2%	3.8%	6.7%	4.5%	4.9%	5.1%	1.3%	4.3%	4.7%	0.3%	3.6%	4.8%	1.2%
Operating profit margin (%)	13.1%	8.5%	8.8%	8.6%	11.5%	8.2%	9.6%	0.8%	9.8%	9.5%	-0.3%	10.1%	9.8%	-0.3%
Net profit margin (%)	10.7%	6.7%	7.5%	7.7%	9.9%	6.9%	7.9%	0.3%	8.2%	8.0%	-0.2%	8.3%	8.2%	-0.1%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Figure 2: Earning revision

(Rmb m)	FY19F			FY20F			FY21F		
	Old	New	Changes	Old	New	Changes	Old	New	Changes
Sales	90,157	89,125	-1.1%	100,335	99,250	-1.1%	111,043	109,914	-1.0%
Sales growth	14.2%	12.8%	-1.3%	11.3%	11.4%	0.1%	10.7%	10.7%	0.1%
GPM incl: tax	37.0%	37.1%	0.1%	37.3%	37.4%	0.1%	37.5%	37.6%	0.1%
OPM	9.3%	9.5%	0.2%	9.3%	9.4%	0.2%	9.8%	9.6%	-0.2%
Net profit	7,000	7,102	1.5%	7,790	7,859	0.9%	9,120	8,873	-2.7%
Net profit growth	7.8%	8.0%	0.2%	7.8%	7.9%	0.2%	8.2%	8.1%	-0.1%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Figure 1: Domestic raw milk price (Rmb/kg)


SOURCES: CGIS RESEARCH, COMPANY DATA, WIND, MINISTRY OF AGRICULTURE

Figure 3: DCF valuation

(Rmb, m)	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F
EBIT	8,266	9,165	10,357	11,595	12,536	13,489	14,446	15,397	16,333	17,244	18,117
Taxes	-1,241	-1,374	-1,551	-1,722	-1,862	-2,004	-2,146	-2,287	-2,426	-2,562	-2,691
EBIT, tax-affected	7,025	7,791	8,806	9,873	10,673	11,485	12,300	13,110	13,907	14,682	15,426
Add: Depreciation & amortisation	1,685	1,990	2,294	2,578	2,882	3,206	3,548	3,906	4,279	4,663	5,056
Add Changes in Working capita	-235	-193	-307	-343	-381	-421	-464	-508	-554	-601	-649
Less Capital Expenditure	-4,500	-4,500	-4,500	-4,456	-4,473	-4,434	-4,334	-4,168	-3,933	-3,624	-3,240
Free Cash Flow to firm	3,975	5,087	6,293	7,652	8,702	9,835	11,049	12,339	13,699	15,120	16,593
YoY growth	16%	28%	24%	22%	14%	13%	12%	12%	11%	10%	10%

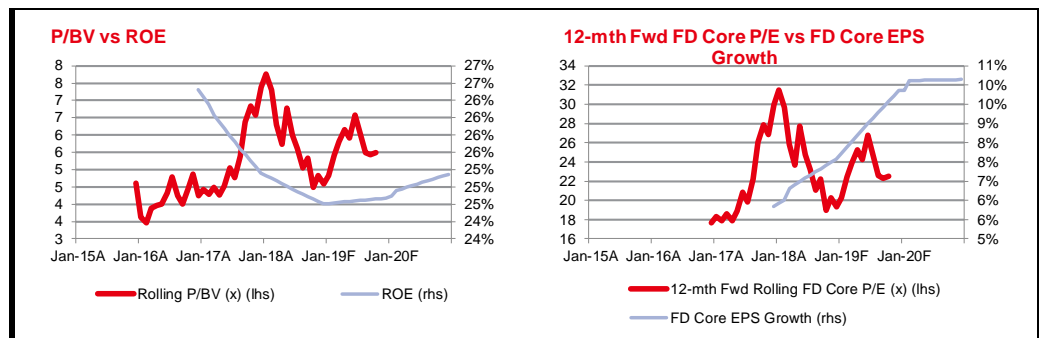
Key assumptions			
NPV of FY19-23 Cash flow	22,670	Industry average beta	0.8
NPV of FY24-29 Cash Flow	41,505	Risk free rate	3.3%
NPV of Terminal Value	136,353	Risk premium	6.3%
Enterprise Value	200,528	Cost of equity	8.5%
Add Net cash/(Net Debt)	9,528	Cost of Debt	3.3%
Less Minority	-122	Debt %	0.9%
Equity value of firm	209,934	Tax rate	15.1%
Share outstanding (m)	6,078	WACC	8.5%
Target price (Rmb)	34.5	Terminal growth rate	3.0%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Figure 4: Peer comparison

Company Name	Bloomberg Ticker	Recom	Target price Local	Last price Local	Quoted currency	Market cap (US\$, m)	P/E (x)		P/BV (x)		EV/EBITDA (x)		ROE (%)		Dividend Yield (%)	
							2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Inner Mongolia Yili Indus-A	600887 CH	ADD	34.50	29.00	Rmb	25,138	24.5	22.2	5.8	5.3	16.3	14.6	24.7	25.1	2.7	3.0
Bright Dairy & Food Co Ltd-A	600597 CH	NR	NA	10.90	Rmb	1,898	28.8	25.6	2.4	2.3	8.0	7.4	8.6	8.9	1.2	1.4
Kweichow Moutai Co Ltd-A	600519 CH	ADD	1328.00	1180.01	Rmb	210,770	34.3	28.9	10.8	8.9	21.7	18.3	34.5	33.7	1.5	1.8
Jiangsu Yanghe Brewery -A	002304 CH	HOLD	108.00	100.79	Rmb	21,597	18.2	16.6	4.1	3.7	11.5	10.6	23.6	23.4	3.3	3.6
Wuliangye Yibin Co Ltd-A	000858 CH	ADD	165.00	132.08	Rmb	72,898	29.9	24.7	7.1	6.2	19.7	16.2	25.3	26.8	1.7	2.0
Sichuan Swellfun Co Ltd-A	600779 CH	NR	NA	53.18	Rmb	3,694	33.9	27.1	11.6	9.6	23.7	19.0	35.6	37.8	2.2	2.7
Luzhou Laojiao Co Ltd-A	000568 CH	NR	NA	87.20	Rmb	18,161	27.2	22.0	6.9	6.2	19.7	15.7	26.5	29.6	2.4	3.0
Shanxi Xinghuacun Fen Wine-A	600809 CH	NR	NA	89.00	Rmb	11,029	39.7	31.9	9.8	8.1	25.1	20.7	25.7	26.0	1.1	1.4
Xinjiang Tianrun Dairy Co-A	600419 CH	NR	NA	13.49	Rmb	397	20.9	17.6	2.8	2.5	NA	NA	12.8	13.1	1.5	1.5
Bright Dairy & Food Co Ltd-A	600597 CH	NR	NA	10.90	Rmb	1,898	28.8	25.6	2.4	2.3	8.0	7.4	8.6	8.9	1.2	1.4
Shanghai Milkground Food -A	600882 CH	NR	NA	13.57	Rmb	790	163.5	33.9	4.3	3.9	NA	NA	2.7	11.4	NA	NA
Average in China domestic F&B market							40.9	25.1	6.2	5.3	17.1	14.4	20.8	22.2	1.9	2.2
China Mengniu Dairy Co	2319 HK	ADD	36.80	31.35	HK\$	15,731	29.1	23.7	3.9	3.5	16.6	14.0	14.2	15.5	1.0	1.3
China Modern Dairy Holdings	1117 HK	ADD	1.50	1.12	HK\$	916	12.7	10.7	0.9	0.8	7.1	6.9	9.8	10.5	0.0	0.0
Want Want China Holdings Ltd	151 HK	ADD	7.50	6.62	HK\$	10,487	21.3	19.6	4.7	4.5	12.6	11.5	22.3	23.4	2.6	3.8
Yashili International Holdin	1230 HK	NR	NA	0.85	HK\$	515	30.5	28.3	0.6	0.6	10.7	10.3	2.1	2.2	0.0	0.7
Average in HK market							23.4	20.6	2.5	2.4	11.7	10.7	12.1	12.9	0.9	1.4
Nestle Sa-Reg	NESN SW	NR	NA	107.14	GBP	322,917	24.3	22.6	5.9	5.9	17.9	17.2	23.4	25.6	2.5	2.6
Unilever Nv-Cva	UNA NA	NR	NA	53.20	EUR	162,387	21.1	19.2	10.8	10.2	14.7	13.6	51.6	52.2	3.1	3.4
Danone	BN FP	NR	NA	75.34	EUR	57,751	19.8	17.9	2.8	2.6	13.9	12.8	14.5	15.2	2.7	3.0
Abbott Laboratories	ABT US	NR	NA	84.01	US\$	148,479	25.9	23.3	3.8	3.0	19.8	18.0	18.2	17.7	1.5	1.6
Almarai Co	ALMARAI AB	NR	NA	49.35	SAR	13,159	22.3	20.7	3.3	3.1	14.4	13.9	13.7	14.0	1.7	2.0
Meiji Holdings Co Ltd	2269 JT	NR	NA	7820.00	JPY	10,994	15.9	16.9	2.1	2.0	9.2	8.7	13.9	12.3	1.7	1.8
Average in International market							21.5	20.1	4.8	4.5	15.0	14.0	22.5	22.8	2.2	2.4

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS

Profit & Loss

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Net Revenues	68,993	80,522	90,263	100,316	110,979
Gross Profit	26,119	30,886	34,241	38,216	42,399
Operating EBITDA	8,705	9,303	10,151	11,354	12,851
Depreciation And Amortisation	-1,475	-1,672	-1,765	-2,070	-2,374
Operating EBIT	7,229	7,631	8,386	9,285	10,477
Financial Income/(Expense)	-113	60	91	84	83
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Non-Operating Income/(Expense)	-42	-113	-120	-120	-120
Profit Before Tax (pre-EI)	7,141	7,675	8,465	9,356	10,548
Exceptional Items					
Pre-tax Profit	7,074	7,578	8,357	9,248	10,440
Taxation	-1,071	-1,126	-1,241	-1,374	-1,551
Exceptional Income - post-tax					
Profit After Tax	6,003	6,452	7,116	7,874	8,889
Minority Interests	-2	-12	-14	-15	-17
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	6,001	6,440	7,102	7,859	8,873
Recurring Net Profit	6,058	6,523	7,194	7,951	8,964
Fully Diluted Recurring Net Profit	6,058	6,523	7,194	7,951	8,964

Cash Flow

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
EBITDA	8,705	9,303	10,151	11,354	12,851
Cash Flow from Invt. & Assoc.					
Change In Working Capital	-571	518	-235	-193	-307
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	-1,014	-1,196	-1,350	-1,490	-1,668
Net Interest (Paid)/Received	-113	0	0	0	0
Tax Paid					
Cashflow From Operations	7,006	8,625	8,566	9,671	10,877
Capex	-3,351	-5,091	-4,500	-4,500	-4,500
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	235	-283	0	0	0
Cash Flow From Investing	-3,117	-5,374	-4,500	-4,500	-4,500
Debt Raised/(repaid)	7,710	-6,337	0	0	0
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	-3,845	-4,393	-4,692	-5,193	-5,862
Preferred Dividends					
Other Financing Cashflow	643	-3,600	0	0	0
Cash Flow From Financing	4,508	-14,330	-4,692	-5,193	-5,862
Total Cash Generated	8,397	-11,079	-627	-22	515
Free Cashflow To Equity	11,599	-3,086	4,066	5,171	6,377
Free Cashflow To Firm	4,003	3,251	4,066	5,171	6,377

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS... cont'd

Balance Sheet

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Cash And Equivalents	21,823	11,051	10,424	10,402	10,917
Total Debtors	2,375	2,896	3,111	3,661	4,278
Inventories	4,640	5,507	5,725	6,376	7,061
Total Other Current Assets	1,007	5,000	5,000	5,000	5,000
Total Current Assets	29,846	24,455	24,261	25,440	27,256
Fixed Assets	13,256	14,688	17,531	20,069	22,303
Total Investments	4,319	5,427	5,427	5,427	5,427
Intangible Assets	525	650	622	594	566
Total Other Non-Current Assets	1,354	2,386	2,386	2,386	2,386
Total Non-current Assets	19,455	23,151	25,966	28,476	30,682
Short-term Debt	7,860	1,523	1,523	1,523	1,523
Current Portion of Long-Term Debt					
Total Creditors	15,954	17,604	17,802	18,809	19,804
Other Current Liabilities	36	44	44	44	44
Total Current Liabilities	23,850	19,171	19,369	20,376	21,371
Total Long-term Debt	0	0	0	0	0
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	210	292	292	292	292
Total Non-current Liabilities	211	292	292	292	292
Total Provisions	0	106	106	106	106
Total Liabilities	24,061	19,569	19,767	20,774	21,769
Shareholders' Equity	25,103	27,916	30,325	32,992	36,003
Minority Interests	136	122	135	150	167
Total Equity	25,240	28,037	30,461	33,142	36,170

Key Ratios

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue Growth	12.0%	16.9%	12.8%	11.4%	10.7%
Operating EBITDA Growth	21.9%	6.9%	9.1%	11.9%	13.2%
Operating EBITDA Margin	12.9%	11.8%	11.4%	11.4%	11.7%
Net Cash Per Share (Rmb)	2.30	1.57	1.46	1.46	1.55
BVPS (Rmb)	4.14	4.59	4.99	5.43	5.92
Gross Interest Cover	64.29	N/A	N/A	N/A	N/A
Effective Tax Rate	15.1%	14.9%	14.9%	14.9%	14.9%
Net Dividend Payout Ratio	70.1%	65.1%	65.1%	65.2%	65.3%
Accounts Receivables Days	4.42	5.16	5.30	5.20	5.39
Inventory Days	38.16	37.31	36.59	35.66	35.76
Accounts Payables Days	61.98	60.98	58.70	53.83	50.95
ROIC (%)	104%	108%	63%	57%	55%
ROCE (%)	25.8%	24.8%	27.8%	28.3%	29.4%
Return On Average Assets	14.0%	13.4%	14.6%	15.2%	15.9%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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Explanation on Equity Ratings

ADD : The stock’s total return is expected to exceed 10% over the next 12 months.

REDUCE : The stock’s total return is expected to fall below 0% or more over the next 12 months.

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